THE COMBINED CODE
AN ANALYSIS OF THE MAIN CHANGES

Institute of Directors
Corporate Governance Comment

Introduction

One of the strengths of the system of corporate governance in the United Kingdom has been its ability to evolve with the changing requirements and expectations of business and markets without the need for much legislative intervention. The system has developed within the overall framework of the law and by building on best practices. Governments have so far shown themselves to be appreciative of the benefits of a non-legislative approach. This approach has been endorsed by the Winter Report in the EU which said "*We finally emphasise that the key input for codes of corporate governance should come from the market and market participants.*"[1]

Evolution of the Combined Code

While there has been governance for as long as there have been companies, the first concerted approach to the issue in the United Kingdom was the establishment in 1991 of the Committee on the Financial Aspects of Corporate Governance under the chairmanship of Sir Adrian Cadbury (the "Cadbury Committee"). Established under the auspices of the Financial Reporting Council ("FRC"), the London Stock Exchange and the accountancy profession it was established because of concerns about the reliability of company reports and accounts, in the wake of certain corporate collapses such as Coloroll and Polly Peck. However, shortly after it began its work more corporate scandal erupted with the failure of the Bank of Credit and Commerce International and the emerging story of Robert Maxwell's affairs. In the light of these events the Cadbury Committee's Report and the Code of Best Practice included in it covered a wider scope than the original remit[2]. The Code of Best Practice was addressed to all listed companies registered in the United Kingdom, but "*as many other companies as possible*" were encouraged "*to aim at meeting its requirements*". Listed companies were **recommended** to state whether they complied with the Code of Best Practice and to give reasons for any areas of non-compliance.

After that, the next aspect of governance to receive attention was the hardy perennial of directors' remuneration. A Study Group on Directors' Remuneration was set up in 1995 under the chairmanship of Sir Richard Greenbury (the "Greenbury Committee") at a time when there was concern among shareholders and the public over executive pay and benefits, particularly in the privatised utilities, and payments to departing directors. The Greenbury Committee reported in July 1995[3]. Another Code of Best Practice was the result. The exhortation to listed companies was slightly stronger. Areas of non-compliance should not only be explained, but also

[1] Report of the High Level Group of Company Law Experts on a Modern Framework for Company Law in Europe (EU November 2002)
[2] Report of the Committee on the Financial Aspects of Corporate Governance (Gee Publishing 1992)
[3] Directors' Remuneration (Gee Publishing 1995)

justified. Further, the London Stock Exchange was recommended to include in the continuing obligations for listed companies a requirement for companies to make a statement in their remuneration reports about their compliance with the recommendations on audit committees, to include remuneration and benefits information for each director.

Not long after publication of the Greenbury Committee recommendations, a Committee on Corporate Governance chaired by Sir Ronnie Hampel (the "Hampel Committee") was asked by the Financial Reporting Council to review existing governance recommendations, establish any new ones it felt relevant and to produce a single code of practice. The final report of the Hampel Committee was published in January 1998[4]. Among its proposals was a combined code on corporate governance. The London Stock Exchange took forward consultation on this and in June 1998 along with a new edition of the Listing Rules, the Principles of Good Governance and Code of Best Practice (the "*Combined Code*") was published[5].

Before the *Combined Code* had been published the government had in March 1998 established a steering group to take forward a fundamental review of company law (the "Company Law Steering Group"). Over the next several years several consultation documents and reports were published, culminating in the Final Report of the Company Law Review in June 2001 (the *Company Law Review)*[6]. In the meantime in mid-2000 Paul Myners had been asked by the Treasury to look at a related problem: whether the long-term good of the markets were being served by institutional investors. Myners reported in June 2001 and made a number of recommendations mainly aimed at pension fund trustees[7]. Arising out of the work of the Company Law Steering Group Derek Higgs was invited by the DTI and the Treasury to conduct a "Review of the role and effectiveness of non-executive directors - Consultation Paper" (the "*Higgs Review*").

Contrary to widely-held belief the *Higgs Review* did not arise out of the various scandals emanating from the USA and rocking confidence in governance across the globe, but out of a statement in the *Company Law Review* that there was "a growing body of evidence from the US suggesting that companies with a strong contingent of non-executives produce superior performance". Indeed, it would be interesting to know whether this phrase would have been included in the terms of reference if Enron etc had taken place a few months earlier.

Derek Higgs published his consultation paper in June 2002[8]. This was an open-ended document seeking answers to a number of wide-ranging questions about board structures, development, procedures and relationships. Meantime, and this time as a result of the US scandals, the DTI had in July 2002 asked the FRC to put in hand development of the existing *Combined Code* guidance on audit committees. The FRC set up a group under the chairmanship of Sir Robert Smith to do this. Sir Robert Smith's group was instructed to liase with Derek Higgs. This liaison took place right through to the publication of the two final reports on the same date in January 2003: of the "review of the role and effectiveness of non-executive directors" (the "*Higgs Report*")[9] and of "Audit Committees Combined Code Guidance" (the *Smith Report*")[10]

[4] Final Report: The Committee on Corporate Governance (Gee Publishing 1998)
[5] Principles of Good Governance and Code of Best Practice (Gee Publishing 1998)
[6] Modern Company Law for a Competitive Economy (DTI 2001)
[7] Institutional Investment in the UK: a review (HM Treasury 2001
[8] Review of the role and effectiveness of non-executive directors (DTI June 2002)
[9] Review of the role and effectiveness of non-executive directors (DTI January 2003)
[10] Audit Committees Combined Code Guidance (FRC January 2003)

What was proposed was an expanded Combined Code. Most of the principles would remain largely unamended, but the number of code provisions with which companies would have to comply or explain would almost double in number. The FRC commenced a consultation exercise. With hindsight this was commenced in a less than felicitous manner. Commentators were invited to bring "fatal flaws in the proposals and any specific drafting matters" to the FRC's attention, but the FRC expressly said it did not propose to re-open the substance of the recommendations. This brought forth widespread condemnation and for some time threatened to obscure the debate. Debate was in fact needed as neither Derek Higgs nor Sir Robert Smith had published any interim recommendations on which comments could be made. Commentators were also unclear where a matter of substance ended and a fatal flaw began. In the end the FRC wisely established a review body, listened to the whole range of comments, and took a large number on board.

It is not the purpose of this paper to rehearse the debate about the content of the revised *Combined Code* but to detail the changes and analyse the possible effects on the corporate governance of UK companies. One thing that has to be recognised at the outset is that the *Combined Code* does not exist in isolation. As it comes into force – for reporting years beginning on or after 1st November 2003 – other consultations and reforms are proceeding. The government has stated its intention to move ahead with certain aspects of the reform of company law including the Operating and Financial Review (the "OFR"), which is to be introduced by secondary legislation under the Companies Act 1985, and reforms arising out of the work of the Co-Ordinating Group on Audit and Accounting Issues[11] and the Review of the Regulatory Regime of the Accounting Profession[12].

The New Combined Code – The New Structure

The *Combined Code* as it has emerged from the consultation process reflects changes in thinking and practice. Over the years much criticism has been directed at a 'box-ticking' and 'boilerplate' approach to the practice of corporate governance. This criticism has not been confined to one side or other of the debate. Companies accuse investors of box-ticking; investors accuse companies of boilerplate. There is some truth on both sides. Many company corporate governance reports could have been cloned from each other. The same is true of, for example, many pension fund statements of investment principles. This can only be ameliorated by informed dialogue and thinking about the realities and practice of corporate governance, not by the taking of entrenched positions that the blame all lies on the other side.

The new structure of the *Combined Code* may help to reduce this approach. This is because what has emerged as the most striking change in the *Combined Code* is the introduction of a category of provision called 'supporting principles'. In the original draft many of what have emerged as these were designated as 'code provisions' which required compliance or explanation. A considerable number were not susceptible to that approach. They were more general in nature. For example, it was difficult to see how a company could comply with or explain departure from the provision: "The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enable risk to be assessed and managed."

[11] Final Report of the Co-Ordinating Group on Audit and Accounting Issues (DTI 29 January 2003)
[12] Report of the Review of the regulatory regime of the Accountancy Profession (January 2003)

That provision has now become a supporting principle. The supporting principles provide a category of provision that are to be treated for reporting purposes in the same way as the Main Principles (formerly the Principles). The Preamble to the *Combined Code* says that: "The form and content of this part of the statement are not prescribed, the intention being that companies should have a free hand to explain their governance policies in the light of the principles, including any special circumstances applying to them which have led to a particular approach." This is a clear steer away from a boilerplate approach and companies should give far more information about policies than before, but it remains to be seen what of substance and interest remains in many cases after the 'professionals' have got their hands on company reports. There is also an ongoing risk that the sheer volume of governance reporting will obscure the real issues.

Moving from the main principles and the supporting principles to the code provisions, with which companies have to confirm they have complied or provide an explanation, again the *Combined Code* continues to stress that explanation can be as valid as compliance. A statement that a company does not 'comply' should not automatically be treated as a breach. There is guidance for both companies and investors. Companies must review each provision carefully and give a considered explanation if it departs from the Code provisions. Those who evaluate governance are exhorted to do so with common sense and to make reasoned judgements about explanations.

As well as the text of the *Combined Code* itself, the document contains a number of schedules relating to various aspects of the provisions. These should provide companies with assistance in both compliance and reporting.

For well-governed companies much of the revised *Combined Code* will not make a great difference to the way in which they operate. In many cases what will change is how much information about that way of operating is in the public domain. The code provisions will impact on those companies where the limits on public information have provided the upper limit on their governance practices.

The New Combined Code – The Changes

In this part each of the Sections of the *Combined Code* will be addressed, and the changes from the 1998 edition will be evaluated. The numbering follows the numbering in the *Combined Code*.

Section 1 Companies

It is this section which contains the provisions against which companies must report.

A. Directors

The Board (A.1):

Main principle

A.1	The main principle now addresses the collective responsibility and accountability of the unitary board.

Supporting principles

	These identify the board's role, particularly leadership and the framework of controls around this. The role of the non-executive directors is stressed

Code provisions

A.1.1	This provision combines two previous provisions dealing with the operation of the board. It now says the annual report should include a statement of how the board operates, including identifying matters delegated to management and those reserved to the board. Previously all that was required was for the board to have a schedule of reserved matters. There has been expansion of the provision on frequency of board meetings.
A.1.2	This new provision derives from a number of previous provisions in setting out who must be identified in the annual report. The annual report should now also show the numbers of board and committee meetings and detail individual director attendance.
A.1.3	This new provision was one of those causing most controversy in the consultation process. There are two parts. Firstly, the chairman should meet the non-executives without the executive directors present. Secondly, the more controversial part deals with the non-executives meeting alone, led by the senior independent director. This now refers to a specific function of this meeting to appraise the chairman's performance. As such this is less controversial, although it could be argued that the executive directors should be involved in that process. The non-executives should also meet when appropriate.
A.1.4	This new provision states that directors should ensure their concerns about the running of the company or any proposed action are recorded in board minutes. If they resign having such concerns they should provide a statement to the chairman for circulation to the board. It will be interesting to see how this provision is used in the context of the collective responsibility of the board.
A.1.5	The subject of D&O liability insurance cover has received a lot of coverage. Companies will now have to provide cover in respect of legal action against directors or explain why they do not.

Chairman and chief executive (A.2):

Main principle

A.2	There is no substantive change to the principle of separation of the roles of chairman and chief executive

Supporting principle

	The particular role of the chairman in relation to leadership of the board is recognised in the supporting principle, and includes his roles in ensuring that the board can function effectively and that all directors are able to make a full contribution

Code provisions

A.2.2	The splitting of the roles of chairman and chief executive is now explicit. This was another of the more controversial provisions expressed in some quarters, but one which the IoD supported.
A.2.3	A new provision dealing with where the chairman should come from. The chairman should be independent on appointment. This is backed by a specific provision saying a chief executive should not go on to become chairman of the same company, except in exceptional circumstances, when major shareholders should be consulted and the reasons given to shareholders at the time and in the next annual report

Board balance and independence (A.3):

Main principle

A.3	This now emphasises the independence of non-executive directors

Supporting principles

	This deals with board size, saying it should be unwieldy but should be large enough to have an appropriate balance of skills and experience and to ensure changes in board personnel can be managed without undue disruption.
	Contrary to board structures in some countries, but recognising what has been a feature of successful UK boards, a strong presence of both executive and non-executive directors is advocated.
	The benefit of committee membership being spread among board members is recognised.
	The need for independence of board committees is shown by saying that only committee members have a right to attend meetings, although the committee may invite others to attend.

Code provisions

A.3.1	For the first time there is a definition of independence for non-executive directors. This has been a contentious issue during consultation but, while it will not stop debates about individual directors, it will provide a single basis against which the arguments take place. As well as a list of relationships that could affect, or appear to affect, a director's independence, it also addresses perceptions of independence.
A.3.2	The proportion of independent non-executive directors was a controversial issue during consultation. The basic requirement is now that at least one half (excluding the chairman) should be independent non-executive directors. Smaller companies (those below the FTSE 350) need only have two independent non-executive directors.
A.3.3	The role of the senior independent director was hotly debated during consultation, as was his existence although that was in the 1998 Code. His role in relation to communication with investors has been more closely defined and is more acceptable.

Appointments to the board (A.4):

The main principle has not changed radically, but the need for appointments to be on merit and against objective criteria form a supporting principle. These are backed by detailed code provisions, including those designed to tackle the issues of availability of time to do the job. Companies are going to have to explain if they do not use a search consultancy or open advertisement in the recruitment of non-executive directors or a chairman.

Main principle

A.4	While appointments have been required to be formal since Cadbury (1992) and transparent since Hampel (1998) they must now be rigorous as well. It will be interesting to see how much progress is made in this area.

Supporting principles

	The recognition that the best people should be on boards is taken up here. The introduction of provisions referring to merit and objective criteria act as a back up to the main principle. The need for directors to have sufficient time to devote to the role is specified as a factor, particularly for the chairman.
	The importance of planning for board and senior management succession is recognised.

Code provisions

A.4.1	All listed companies should now have a nomination committee. This is the one committee required by the Combined Code where not all members have to be independent non-executive directors – just a majority. The original Higgs recommendation was that the Chairman should not chair the nomination committee. The IoD (along with many others) opposed this, and we are pleased that the chairman is now permitted to chair this committee (except when dealing with his succession) as its work is key to the structure and functioning of the board, which the chairman is responsible for leading.
A.4.2	The nomination committee should evaluate the balance of skills, knowledge and experience and draw up personal and role descriptions when making appointments. This new provision is intended to make for better balanced boards.
A.4.3	For an appointment as chairman the time commitment must be assessed and his other significant commitments disclosed to the board before appointment and reported to members in the first annual report following appointment. Changes should be notified to the board. This emphasises the importance of the role of chairman and the need for him to be able to devote sufficient time to the company. No-one should chair more than one FTSE company
A.4.4	Non-executive directors' terms of engagement should be available for inspection (at the registered office and at the AGM). The letter of appointment should set out the expected time commitment, and the non-executive director will have to undertake he has sufficient time to meet what is required of him. Other significant appointments must be disclosed to the board before appointment and if they change, but need not be disclosed in the annual report.

A.4.5	Given the discussion about sources of non-executive directors, this provision limits the scope for executive directors to take on non-executive roles. They should take not more than one non-executive directorship in a FTSE 100 company and should not chair a FTSE 100 company.
A.4.6	The work of the nomination committee should be described in a separate section of the annual report, including explanation if neither search consultancy nor open advertisement is used in non-executive and chairman appointments.

Information and professional development (A.5):

This provision has been greatly expanded, with responsibilities being clearly laid down, and the need for induction and ongoing development of directors included for the first time. Some of these provisions have significant resource and potential financial implications for companies.

Main principle

A.5	As well as the provision of appropriate and timely information, the importance of the induction and training of directors is included for the first time.

Supporting principles

	Responsibility for ensuring directors receive information is placed on the chairman, although it is a management obligation to provide it. Directors should not simply claim lack of information, but should seek clarification or amplification if necessary.
	Ensuring updating of directors' knowledge and skills is placed on the chairman, with the company obliged to provide the necessary resources.
	Ensuring good information flow is a responsibility of the company secretary, under the direction of the chairman. The company secretary must also facilitate induction and professional development.
	Advice on corporate governance lies with the company secretary through the chairman.

Code provisions

A.5.1	On first appointment directors should receive full, formal and tailored induction. It will not be sufficient to have a standard package for all directors. Major shareholders should be offered the opportunity to meet new non-executive directors.
A.5.2	All directors (but especially non-executives) should have access to independent professional advice at the company's expense. Resources should be provided to enable committees to undertake their functions.
A.5.3	The role of the company secretary is enhanced, and removal is made a matter for a full board decision.

Performance evaluation (A.6):

The requirement that boards should formally and rigorously review their own performance and that of individual members is entirely new.

Main principle

A.6	A formal, rigorous, annual evaluation should be undertaken by the board of its own performance, that of its committees and of its individual members.

Supporting principle

	The purpose of the individual evaluation is to assess whether each member contributes effectively and demonstrates commitment (including time). The chairman should act on results, where necessary proposing new members be appointed or seeking resignations.

Code provisions

A.6.1	The annual report should state how the required evaluations have been conducted. Evaluation of the chairman should be by the non-executive directors, led by the senior independent director, taking account of the views of the executive directors.

Re-election (A.7):

These provisions (formerly A.6) have been strengthened, particularly with regard to the election and re-election of non-executive directors and the overall terms they serve.

Main provision

A.7	Reference to continuing satisfactory performance of an individual director, and also planned and progressive refreshment of the board gives substance to the regular re-election provisions.

Code provisions

A.7.1	This has no substantial amendments.
A.7.2	This provision has been greatly expanded. Resolutions to elect a non-executive director should set out reasons why the board thinks they should be elected. Where a director is to be re-elected the chairman should confirm that his appraisal has been satisfactory. If a non-executive director is to be re-elected beyond six years the review should be particularly rigorous and should take account the need for boards to be refreshed. Service as a non-executive director beyond nine years should be subject to annual re-election

B. Remuneration

This is probably the single area where companies' practices and compliance with the Combined Code are under most constant scrutiny from investors and the media. The provisions are not a radical change from the provisions under which the current debate has been taking place. If the Combined Code is to survive and not be replaced by legislation, more than lip service has to be paid to compliance or explanation.

The level and make up of remuneration (B.1):

Main principle

B.1	There are no major changes to the basic principle, but the proportion of remuneration linked to corporate and individual performance should in future be 'significant'.

Supporting principle

	This supporting principle closely follows the former code provisions B.1.2 and B.1.3

Code provisions

B.1.1	This is unchanged from former code provision B.1.4 and B.1.6. dealing with performance related pay and the design of schemes of performance related pay.
B.1.2	The requirements regarding issuing options at a discount are substantially unchanged.
B.1.3	For the first time there are provisions on non-executive remuneration, with a specific statement that it should not include share options, but may do so exceptionally and with prior shareholder approval. A warning that to do this might affect independence is included.
B.1.4	If executive directors serve as non-executives elsewhere the annual report should state whether they retain their earnings from that position and, if they do, what those earnings are.
B.1.5	There are no major changes in the provisions on compensation commitments arising out of directors' terms of appointment. Application of this provision will be subject to even more rigorous scrutiny than before.
B.1.6	Setting notice periods at one year or less is put in stronger terms.

Procedure (B.2):

There have been few substantive amendments to the provisions on procedures for developing remuneration policy. The previous provisions on disclosure of directors' remuneration have been deleted from the *Combined Code*. The reason for this is that they have been superseded by the statutory requirements of The Directors' Remuneration Report Regulations 2002 (SI no. 1986 2002).

Main principle

B.2	The requirement for formal and transparent procedures and the bar on a director being involved in decisions on his or her own pay are unchanged.

Supporting principles

	This builds on the provision of the former provisions. As well as consulting with the chairman and/or chief executive, the remuneration committee is now the body responsible for appointment of remuneration consultants. The committee should also be aware of potential conflicts if executive directors or senior managers support or advise the committee.
	This repeats former provision B.2.6 regarding contact with investors on remuneration.

Code provisions

B.2.1	The membership of the remuneration committee should be entirely independent directors (at least three or, for companies outside the FTSE 350, two). There is greater transparency of the terms of reference, its role and the authority delegated to it, also of other relationships remuneration consultants have with the company.
B.2.2	The role of the remuneration committee is extended to the chairman's remuneration. It should also monitor the level and structure of senior management pay (i.e. the first level below the board).
B.2.3	The provision on determination of non-executive remuneration is unchanged.
B.2.4	Although moved (from B.3), the requirement for shareholders to approve all new long-term incentive schemes is unchanged.

C. Accountability and audit

This was formerly Section D.

Financial reporting (C.1):

These provisions have not been changed in substance. They are based on the principle that the board should present a balanced and understandable assessment of the company's position and prospects.

Main principle

C.1	This is unchanged from former D.1

Supporting principle

	This was formerly code provision D.1.2

Code provisions

C.1.1	The only addition is to clarify that the explanation of the directors' responsibility for preparation of the accounts is to be made in the annual report.
C.1.2	The report on going concern is unchanged.

Internal control (C.2):

The requirement to maintain a sound system of internal control and to review it at least annually remains substantively the same. The footnotes refer to the Turnbull guidance.

Main principle

C.2	This is unchanged.

Code provision

C.2.1	The requirement for annual review of systems of internal control is substantially unchanged.

Audit committee and auditors (C.3):

Although the main principle is unchanged there are wide-ranging changes to how this will be applied. The value of audit committees should be enhanced by the need for at least one member to have 'recent and relevant financial experience'. The duties of the audit committee are set out in some detail. There are new provisions on whistleblowing and the review of the effectiveness of internal controls. Important new provisions are the enhanced role of the audit committee in the appointment or removal of external auditors and the requirement for explanation of how auditor objectivity and independence are safeguarded if the auditor provides non-audit services.

Main principle

C.3	This is unchanged.

Code provisions

C.3.1	The membership of the audit committee should be entirely independent directors (at least three or, for companies outside the FTSE 350, two). At least one member should have recent and relevant financial experience. This last has led to the view in some quarters that finding members of audit committees may prove difficult.
C.3.2	What is to be included in the audit committee's duties is now set out in detail.
C.3.3	This new provision stated the terms of reference of the audit committee should be made available, and how it fulfils its duties should be described in a separate section of the annual report.
C.3.4	This introduces a requirement on the audit committee to review the company's 'whistleblowing' arrangements with the aim of ensuring arrangements are in place for investigation and follow-up of complaints..
C.3.5	The role of the audit committee with regard to internal audit is new.
C.3.6	The audit committee is given prime responsibility for recommendations on appointment, reappointment and removal of external auditors, with a requirement to state in the annual report if the board rejects its recommendations.

C.3.7	There is no absolute bar on auditors providing non-audit services, but if the auditor provides such services the annual report should state how auditor objectivity and independence is safeguarded.

D. Relations with shareholders

This was previously Section C.

Dialogue with institutional shareholders (D.1):

The responsibility for ensuring that this is satisfactory is now clearly placed on the whole board. The code provisions back up the role of different elements of the board in securing the overall purpose.

Main principle

D.1	This makes clear that ensuring satisfactory dialogue with shareholders is the responsibility of the whole board. Although the section is headed dialogue with institutional shareholders, the principle makes no distinction.

Supporting principles

	This identifies that while the chief executive and finance director take the lead in dialogue with shareholders there are roles for the chairman and, where appropriate, the senior independent director and other directors.
	The board should use the most practical and efficient ways to keep in touch with shareholder opinion.

Code provisions

D.1.1	This is the final outcome of the provisions that caused a lot of controversy in the original draft (not least from the IoD), which gave a leading role to the senior independent director. That role has been modified to attendance at a sufficient number of meetings, and the possible involvement of other non-executive directors in meetings has been recognised.
D.1.2	This requires a statement in the annual report explaining the steps taken to ensure all board members develop an understanding of the views of major shareholders.

Constructive use of the AGM (D.2):

There have been changes here to recommend that all directors should attend and to the announcement of votes cast.

Main principle

D.2	The use of the annual meeting to communicate with investors now encompasses all investors, not just private investors.

Code provisions

D.2.1	This goes some way to recognising some of the problems with voting. Companies should now indicate levels of abstentions as well as votes for and against. There is also a requirement to ensure votes are properly received and recorded. This last is the subject of some continuing further work.
D.2.2	The requirement for separate resolutions on each substantially separate matter is unchanged.
D.2.3	In future not just the chairmen of the committees should attend, but the chairman should arrange for all directors to attend.
D.2.4	The timing of the issue of notice and papers for the annual meeting are unchanged at 20 working days.

These are all the provisions against which the company has to report. There is also a Section 2 to the *Combined Code* addressed to institutional shareholders, which is set out below. This section is not subject to any sanction, but it does stress the need for institutional shareholders to consider carefully explanations for departure from the *Combined Code* and make a reasoned judgement in each case. The whole issue of the dialogue and relationship between companies and their investors is an ongoing one, as stated by Sir Bryan Nicholson in the FRC press release accompanying the issue of the *Combined Code*.

Section 2 Institutional investors

E. Relations with shareholders

Dialogue with companies (E.1):

Main principle

E.1	Previously E.2, this has been slightly strengthened.

Supporting principle

	Institutional investors are directed to apply the principles set out in the Institutional Shareholders' Committee's *The Responsibilities of Institutional Shareholders and Agents – Statement of Principles*.

Evaluation of Governance Disclosures (E.2):

Main principle

	There is no change in the principle of giving due weight to relevant factors drawn to the investor's attention.

Supporting principle

	This is new and requires reasoned judgement taking account of the issues facing the particular company. Explanation should be given to the company, with readiness to enter into dialogue if the company's position is not accepted. Avoidance of a box-ticking approach is specifically mentioned.

Shareholder voting (E.3):

Main principle

E.3	The responsibility to make a considered use of votes is unchanged.

Supporting principles

	This is unchanged from the previous code provision E.1.3 regarding translating voting intentions into practice.
	This is unchanged from previous code provision E.1.2 on information to clients on voting.
	Major shareholders are now told they should attend annual meetings where appropriate and practical, and this should be facilitated by registrars.

Conclusion

Since much of the *Combined Code* contains provisions that companies have to comply with or explain for the whole reporting period, they should be looking at their policies and practices now and seeing what issues they need to be addressing. This does not mean that companies should make ill-thought through changes to be able to report that they are compliant, but they must be able to give properly justified explanations. Investors for their part must accept that there will not be overnight change. They should recognise it is better for a company to be reviewing their policies and structure to achieve a lasting result than achieving apparent 'compliance'.

Finally, corporate governance and the *Combined Code* should be means to facilitate company success in the long-term. We should avoid becoming so driven by adherence to correct procedure that we lose sight of the main purpose of the company.

Patricia Peter, Corporate Governance Executive
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